Via email to rule-comments@sec.gov

February 3, 2020

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: **Proposed Rule on Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice; File Number S7-22-19**

Dear Ms. Countryman:

We believe that the Commission has failed to acknowledge a number of fundamental legal issues which would substantially increase the costs that the rule would impose on working Americans and put its viability into serious question. These shortcomings result primarily from failure of the proposal to take into consideration its effects on the legal obligations of fiduciary shareholders that hold proxy voting rights on behalf of pension, college savings and other long-term investment fund participants.

In particular, **the Commission appears to have largely ignored investor fiduciary duties** that legally obligate fiduciary shareholders to manage costs, including through engagement of shared outside proxy experts; exercise prudence in selecting, contracting and monitoring proxy advisors; use a forward-looking analysis of voting trends and proxy issues, including risks, benefits and opportunities over both the short and long term; and manage service provider conflicts of interest. Inattention to the impact of these shareholder fiduciary duties causes the proposal to:

- **Conflict with and impede the ability of institutional investor fiduciaries to exercise their fiduciary duties** under the Employee Retirement Income Security Act (ERISA), the common law of trusts, and state laws governing fiduciary responsibilities of public pension plans, foundations, endowments and other trust funds;
- **Ignore existing SEC regulatory provisions which provide the means to more directly resolve the purported issues** cited in the rulemaking proposal;
- Impose unnecessary additional costs on shareholder fiduciaries that result from **forcing unconstitutional "compelled speech" obligations upon fiduciary-contracted proxy advisors**, in violation of the First Amendment; and
- Overlook potential conflicts, risks, liabilities and costs associated with creation of a confidential process for interaction between companies and proxy advisors, which investors fear could result in coerced inclusion of non-transparent, opinion-motivated changes in proxy advisor report analyses that are inconsistent with shareholder fiduciary duties.[1] **Allowing companies to**

[1] For example, the Council of Institutional Investors' comment on the proposal cautions, "The requirements impair the independence of the proxy advisor research for at least two reasons: (1) the proxy advisor is required to seek review and receive feedback from the self-interested company before sharing the draft report with their own paying institutional investors clients; and (2) the proxy advisor advice to clients is subject to heightened liability to the issuer under SEC Rule 14a-9. We believe the impairment of the independence of the proxy advisor would reduce the reliability and completeness of voting advice." The comment letter from Minerva Analytics says, "[T]he

confidentially assert influence over proxy advisor recommendations to shareholder fiduciaries is a slippery slope that could lead to dilution of institutional investors' duty of loyalty to fund participants. That is exact what ERISA provisions imposing liability on "functional fiduciaries" is intended to prevent.[2]

We recommend that the Commission read our Boston University Law Review article, *"Proxy Voting Reform: What is on the Agenda, What is not on the Agenda, and Why it Matters for Asset Owners,"* (hereinafter "the BU Article") before proceeding further with the proposed rule.[3] The article describes institutional investor fiduciary duties that apply to the exercise of proxy voting rights and is available at:

https://www.bu.edu/bulawreview/files/2019/06/JOHNSON-WILLIAMS-AND-AGUILERA-.pdf.

Conflicts with Investor Fiduciary Duties

ERISA, Department of Labor regulations issued pursuant to ERISA, the common law and state statutes govern fiduciary duties of institutional asset owner fiduciaries, including their obligations relating to proxy voting. These shareholder fiduciaries are responsible for the vast majority of proxy votes cast, and their duties are described in detail in the BU Article. However, **the proposal gives little attention to shareholder fiduciary duties and often mischaracterizes them when they are discussed**. This results in an erroneous analysis of the proposal's costs and an overreach of SEC authority.

For example, the proposal incorrectly seems to assume that attention to material long-term risk and return ramifications of proxy issues (which fiduciaries with long-term liabilities must evaluate to comply with their duties of loyalty and impartiality) constitutes service to an improper non-financial agenda. Consideration of environmental, social and governance (ESG) matters also seem to be presumed as inappropriate, even though the Department of Labor has determined that ESG factors can often be material financial considerations and many of the world's largest institutional investors (e.g., BlackRock and State Street Global Advisors) have publicly stated that evaluation of ESG matters is essential to prudent investment management practices.[4] Duties of investor fiduciaries to carefully select, contract and monitor proxy advisors are subverted by the imposition of conflicting proxy advisor obligations.

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proposed regulations will create an even more hostile and lop-sided operating environment for proxy research. That issuers will be able to sue proxy analysts for “errors” but issuers face no similar recourse for either “little r” restatements or “Big R Restatements”, the legal risks for analysts far outweigh the commercial benefit"

[2] The "functional fiduciary" principle was described in *Olson v.E. F. Hutton & Co., Inc.,* 957 F.2d 622 (8th Cir. 1992) in addressing when a broker would become a functional fiduciary through his influence over pension plan investments. "[This] interpretation is consistent with Congress' desire that ERISA protect "the interests of participants in employee benefit plans and their beneficiaries," 29 U.S.C. § 1001(b) (1988), because it imposes fiduciary status upon those who act like fiduciaries as well as those who actually are fiduciaries."

[3] We will not repeat here the citations to authority on fiduciary duty that are contained in the BU Article.

[4] For example, in Field Assistance Bulletin 2018-01, the Department of Labor affirmed the meaning of its prior guidance. "[The] Department merely recognized that there could be instances when otherwise collateral ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company’s business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, these ordinarily collateral issues are themselves appropriate economic considerations, and thus should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments." See also Department of Labor Interpretive Bulletin 2016-01.

Furthermore, despite fiduciary prohibitions on the diversion of trust funds to benefit third parties, the proposal seeks to shift corporate costs to shareholder fiduciaries (through a mandate that their contracted proxy advisors provide investor communication services to issuers) to promote opinions and analytical methodologies that conflict with policies already determined by the fiduciaries to be consistent with their fiduciary duties to fund participants.

The proposal fails to consider costs associated with these conflicts. It also does not analyze the extent to which the SEC's statutory authority is limited when SEC regulations are inconsistent with shareholder fiduciary duties under existing state and federal laws.

Existing SEC Guidance Addresses Proxy Advisor Oversight

Through Interpretive Release IC-33605 (effective September 10, 2019) and prior regulatory interpretations, the SEC has already provided extensive guidance to investment advisors on management of the purported issues sought to be addressed by the proposal.[5] The Department of Labor has established similar guidance for proxy voting on holdings of pension fund fiduciaries in Field Assistance Bulleting 2018-01 and Interpretive Bulletin 2016-01.

Unlike the current proposal, these interpretive releases do not invert the relationship between shareholder fiduciaries and their proxy advisors. They recognize that asset owner fiduciaries are the ultimate authority responsible for establishing proxy policies, selecting service providers and monitoring implementation of their policies. Conversely, the proposal treats proxy advisors as though they are the principals who control investment advisors and named fiduciary asset owners, rather than the agents selected, contracted and monitored by asset owners.

This is a fatal flaw. Asset owners sit at the top of the fiduciary chain of command. Though they can delegate specific duties, asset owners (e.g., named fiduciaries) are ultimately the responsible party. Proxy advisors and companies cannot override policies and contractual mandates of the ultimate fiduciaries. Unlike the SEC's prior Interpretive Release, the proposal has the principle-agent relationship backwards. Companies need to directly communicate more effectively with the principals in the proxy advisor-shareholder fiduciary relationship. **Ultimately, the proposal is a distraction from the real issue, which is failure of the SEC's reporting standards to require that companies provide investors and proxy advisors with the information needed to understand company perspectives on the investor concerns which underlie proxy proposals.**

The SEC has a regulatory framework in place that it could use to address purported issues cited in the proposal. By inverting the principal-agent relationship, the rule is likely to be both ineffective and produce costly side effects that have been highlighted in many other comment letters submitted by shareholder fiduciaries on the proposal.

[5] For example, SEC Staff Legal Bulletin No. 20 (June 30, 2014).

Violation of First Amendment Limits on Compelled Speech

Companies already have an obligation to disclose the information that shareholders deem material for investment decision making, and this includes information material to proxy vote determinations.[6] Unfortunately, the SEC's reporting standards have not kept up with evolution of investor practices. Many ESG issues, as well as other long-term risks and opportunities, have become material to investment and proxy voting analytical processes of many mainstream investors. They often become the subject of shareholder resolutions because SEC reporting standards are out of date and inadequate.

Unfortunately, **the SEC appears to be using this proposal as a back door way to transfer responsibility for resolving inadequate proxy disclosures and related costs from companies to shareholders**, via imposition of proxy report prior review and consultation obligations. The predictable result of these imposed costs will be inefficient, last minute negotiations that leave proxy voters with insufficient time to absorb what is likely to be viewed as potentially compromised analyses. The process also appears to be unconstitutional.

Recent court decisions on "compelled speech" cast doubt on constitutionality of the proposed rule. The Commission cannot proceed without a full analysis of whether the proposal runs afoul of First Amendment limits on compelled speech.[7] Given the issues cited above about the proposal's conflict with fiduciary duty law, potential for use of existing regulatory alternatives and lack of certainty that the rule would be effective, there seems to be little basis to support the proposal.

Erosion of Fiduciary Standard and "Functional Fiduciary" Status

As a practical matter, creation of a confidential issuer review process for draft proxy advisor reports prior to end user fiduciaries even seeing the report is likely to create more problems than it solves. The potential for secret meetings where companies leverage threats of liability to coerce subtle proxy advisor changes in mixed fact-opinion analyses of proxy issues will introduce a major new conflict of interest into the proxy advisor service delivery chain used by shareholder fiduciaries. It is likely to undermine fiduciaries' confidence that the proxy advisor's work product adheres to fiduciaries' established policies and methodologies.[8]

The proposed issuer review process also appears likely to create a risk that some companies could become exposed to allegations that their influence over proxy advisors makes them a "functional fiduciary" to shareholder fiduciaries. ERISA section 3(21)(A) provides that a person may become a fiduciary with respect to a pension plan to the extent he or she "exercises any authority or control with respect to management or disposition of its assets." It is not required that the person have

[6] Courts have described the threshold for reporting obligations under securities law as whether there is a substantial likelihood that a reasonable investor would have considered the subject information important in making his or her investment or voting decision. Basic Inc. v. Levinson, 485 U.S. 224 (1988)

[7] "In simple terms, the First Amendment does not permit the government to compel a person to pay for another party's speech just because the government thinks that the speech furthers the interests of the person who does not want to pay." Janus v AFSCME 585 U. S. (2018) (Holding that compelled subsidies for speech had to "serve a compelling state interest that cannot be achieved through means significantly less restrictive of associational freedoms.")

[8] See footnote 1, above.

discretionary authority to be held liable, as "it is enough that one actually exercises any form of authority or control."[9]

Unfortunately, the proposal fails to consider the impacts on shareholder fiduciaries and the potential danger that issuers could face liabilities from their erosion of investor fiduciary standards and related company "functional fiduciary" liability exposure. Given that SEC alternatives are already in place which could be used to address the purported problems cited in the proposal, this calls into question the Commission's expressed rationale for the proposal.

Thank you for considering these comments. We hope they are helpful.

Sincerely,

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[9] Lopresti v. Terwilliger, 126 F.3d 34, 40 (2d Cir. 1997) ("Congress intended ERISA's definition of fiduciary "to be broadly construed." Blatt v. Marshall Lassman, 812 F.2d 810, 812 (2d Cir. 1987). "Unlike the common law definition under which fiduciary status is determined by virtue of the position a person holds, ERISA's definition is functional." Mason Tenders Dist. Council Pension Fund v. Messera, 958 F. Supp. 869, 881 (S.D.N.Y 1997) (citing, inter alia, Mertens v. Hewitt Assocs., 508 U.S. 248, 262 (1993)). Section 1002(21)(A) of ERISA defines a fiduciary in several ways. In relevant part, that statute provides that a "person is a fiduciary with respect to a plan," and therefore subject to ERISA fiduciary duties, "to the extent" that he or she "exercises any authority or control respecting management or disposition of [plan] assets," or, "has any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. § 1002(21)(A)(i) and (iii).")